Nos. 164 - 165

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CHARLES ELMORE CROPLEY

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

NOS. 8591 AND 8597

LORRAINE CASTLE APARTMENTS BUILDING CORPORATION, INC., *et al.*,

Petitioners,

vs.

JUSTIN MACKIEWICH, *et al.*,

Respondents.

ANGELO CASTELLANI, *et al.*,

Petitioners,

vs.

JAMES W. McNICHOLS, TRUSTEE, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF OF JAMES W. McNICHOLS, TRUSTEE IN OPPOSITION.

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REPORT OF OPINION IN CIRCUIT COURT OF APPEALS.

The opinion of the Circuit Court of Appeals is set forth in full at pages 495 to 502 of the printed record. We shall refer to the opinion as it appears in the printed record.

STATEMENT OF FACTS.

We wish to concisely present only those facts which we consider necessary and pertinent. The original mortgage secured by the property owned by the Debtor corporation herein was $100,000.00, with interest at 6% per annum, maturing May 1, 1935. This amount had been reduced under a Section 77-B Reorganization and retirement of bonds to $72,500.00 with interest at 3% per annum as of April 7, 1942. On April 30, 1942, the Debtor corporation instituted these proceedings (R. 2-10) and an order was entered upon said petition finding that the same was filed in good faith and in compliance with the Act of Congress (R. 11-14). The matter was referred to a Special Master for hearing (R. 12). The Debtor corporation filed its first Plan of Reorganization on August 12, 1942 (R. 21-24) providing for retirement of bonds and payment to the bondholders of 70c on the dollar. After numerous hearings, the Special Master filed his report on October 6, 1942, recommending the disapproval of the Debtor's Plan of Reorganization as submitted and stated that there existed a buyer who was offering approximately $2,250.00 more for the Debtor's property than was being offered by the Debtor itself in full satisfaction of the outstanding indebtedness (R. 24-32) and the Special Master stated that unless the Debtor increased its offer to pay the bondholders 85c on the dollar he would recommend a liquidation (R. 29-30).

After this statement was made on November 24, 1942, Ward Farnsworth, a well-known real estate appraiser, appraised the property as having a value of $61,000.00 and the Debtor corporation then filed its petition for leave to amend the Plan of Reorganization increasing the proposed payment to the bondholders from 70c to 80c on the

dollar as their respective distributive share (R. 33). On December 17, 1942, the Special Master reiterated his statement that the distribution to the bondholders should be at least 85c on the dollar of the face amount of the bonds before he would approve a Plan of Reorganization, and further stated that in his opinion an offer of 80c on the dollar is not sufficient (R. 47-52). The Debtor at that time suggested to the Court that the claims of the so-called speculators should be limited to their actual purchase price of the respective bonds which they had acquired (R. 84). On May 13, 1943, Appraisal Associates, Inc., filed its report and appraisal evaluating the property of the Debtor at $73,250.00 (R. 93-101). On September 1, 1943, Paul A. Hazard, an appraiser appointed by the District Judge, filed his report and appraisal, stating that the present cash market value of the Debtor's property was $75,000.00 (R. 114-125). Thereafter on September 7, 1943, James W. McNichols, the duly appointed and qualified acting Trustee, submitted and proposed the Trustee's Plan of Reorganization, which fixed a minimum sale price of $75,000.00 and proposed a reorganization and sale with an upset price pursuant to the provisions of Section 216(10) of Chapter X of the Bankruptcy Act as amended (R. 126-130).

On November 1, 1943, the Debtor, its stockholders and bondholders, presented a motion for leave to file a petition praying for an order limiting the allowance of claims of bondholders who purchased securities during the pendency of these proceedings and requesting that their claims be limited to the amounts of the respective purchase prices actually paid (R. 168, 450, 452-456).

The Special Master in his report of October 7, 1943, recommended approval of the Trustee's Plan of Reorganization (R. 158) and stated that he had been advised that

the Trustee had received an offer of purchase for the Debtor's property in the amount of $75,000.00, accompanied by a cashier's check of $7,500.00, as earnest money upon a contract for the purchase of the Debtor's property. The prospective purchasers were procured by a real estate broker and were not acquainted with any of the parties to the litigation.

While the record contains many pages of testimony by Nelson Anderson, William Bart, Irving Greenfield, Justin Mackiewich, William Henning Rubin, Charles Turner, Frank Wallach, and others, before the Special Master, and both the testimony and evidence submitted dealt with the activity of the so-called speculators in purchasing bonds during the pendency of these proceedings, the Special Master found that there was no fraud involved in the purchase of these bonds, and that the purchasers are not and never were in a fiduciary relationship with the bondholders, the Debtor, stockholders of the Debtor (R. 160-161). Examination of the lengthy and exhaustive hearings as shown by the record well demonstrates that the petitioner was given ample opportunity to present all matters pertaining to this issue but that the evidence, as presented, did not support a finding of fraud, collusion and that no fiduciary relationship existed (R. 498).

The Special Master also recommended that the Plan of Reorganization filed by the Debtor lacked feasibility and should be disapproved; that the objections filed by the Debtor to the Trustee's Plan of Reorganization be overruled (R. 161-163). Objections to the Referee's Report were filed on October 12, 1943.

Thereafter, on February 10, 1944, the District Judge filed a memorandum opinion (R. 446-451) finding that the Debtor's Plan was unfair and not feasible; that the Trus-

tee's Plan was fair and feasible; that the evidence in the case did not warrant disturbing the findings of the Special Master; that there was no fraud involved in the purchase of the bonds during the pendency of this proceeding, and that the purchasers were not in a fiduciary relationship with the bondholders, the Debtor, or stockholders of the Debtor. The Court also entered an order granting the Debtor leave to file its petition for allowance and limitation of certain claims and denied said petition (R. 452-456). On February 21, 1944, the District Judge entered an order approving the Special Master's Report approving the Trustee's Plan of Reorganization as fair, equitable and feasible and disapproving the Debtor's proposed Amended Plan (R. 457-460). From these last orders Angelo Castellani and Margaret Castellani perfected an appeal to the Circuit Court of Appeals (R. 461) (R. 477) and thereafter on May 4, 1945, the Circuit Court of Appeals for the 7th Circuit affirmed the orders entered by the District Court (R. 495-502). It is upon this record that a Writ of Certiorari is sought.

ARGUMENT.

A.

Chapter X Of The Bankruptcy Act Specifically Authorizes A Reorganization Of The Debtor By A Sale Of The Debtor's Assets At A Fair Upset Price As A Reorganization And Not A Liquidation.

Petitioners again contend that the present Plan of Reorganization is not a reorganization but a liquidation since it tends to deprive the holders of Debtor's securities from continued participation in the Debtor or the Debtor's successor corporation. This argument has been refuted before the District Court and the Circuit Court of Appeals; we shall again demonstrate the fallacy in Petitioner's position.

The District Judge's approval of the Trustee's Plan of Reorganization and the disapproval of the Debtor's Amended Plan of Reorganization was in conformity with the provisions of Chapter X of the Bankruptcy Act as amended and was proper. This position was affirmed by the Circuit Court of Appeals (R. 495-502).

On April 30, 1942 the Debtor corporation filed its petition (R. 2-10) and an order was entered upon said petition finding that the same was filed in good faith and in compliance with the Act of Congress (R. 11-14). After the Special Master duly considered the Plan of Reorganization as filed by the Debtor and recommended its disapproval and after the Debtor amended its Plan of Reorganization and subsequently filed its amended Plan, the District Judge appointed a Trustee who submitted the Trustee's Plan of Reorganization which was approved as amended (R. 457-460).

On September 1, 1943, Paul Hazard, an Appraiser appointed by the District Judge, filed an appraisal report in which he set forth that the present cash market value of the Debtor's lands and buildings was $75,000.00. The Trustee's Plan of Reorganization, as approved, provided that the Special Master shall offer the Debtor's property for sale to the highest bidder with an upset price of $75,000.00.

It should be noted in passing that the first Plan of Reorganization submitted by the Debtor corporation on August 12, 1942, (R. 21-24) provided for payment to the bondholders of only 70c on the dollar. On October 6, 1942, the Special Master stated that a buyer had offered $9,250.00 more than was offered by the Debtor for the property (R. 29). In recommending that the Debtor's Plan be disapproved, the Special Master stated:

> "There is every indication that at least 85% of the face value of the bonds can be realized * * * and unless the Debtor's offer is increased so as to pay the bondholders 85c on the dollar of the face value of their bonds I would respectfully recommend that an order of liquidation be entered and the property sold in accordance with the provisions of the Bankruptcy Act made and provided (R. 30)."

The Debtor, in spite of this statement by the Special Master, did not increase its offer to 85c on the dollar but instead filed a petition for leave to amend the Debtor's Plan of Reorganization to increase payment to the bondholders from 70c to 80c on the dollar (R. 33). At no time did the Debtor see fit to increase its offer to the respective bondholders in accordance with the increased valuation of the property, and in fact refused to do so (R. 202).

The District Judge has the authority in a Chapter X proceeding to approve a plan providing for the sale of all

of the Debtor's property at not less than a fair upset price. This is specifically provided for in Section 216(10) (11 U. S. C. Sec. 616(10)) of the Act.

Section 216(10) provides in part as follows:

> "A Plan of Reorganization under this Chapter * * * (10) shall provide adequate means for the execution of the Plan which may include the retention by the Debtor of all or any part of its property; *the sale of all or any part of its property, either subject to or free from any lien, at not less than a fair upset price* and the distribution of all or any assets, or proceeds derived from the sale thereof, among those having an interest therein." (Italics ours.)

The language is clear and explicit. There can be no doubt that the framers of this section and Congress clearly authorized and intended the Court to approve sales with an upset price and approve a Plan of Reorganization containing provisions for an upset price sale as a Plan of Reorganization and not in the nature of a liquidation.

A recent case which raised the same issues and which confirmed the position taken by the District Court under Section 216(10) is *Country Life Apartments* v. *Buckley,* 145 Fed. 2d, 935 (C. C. A. 2nd, Dec. 1944). In this case the Circuit Court of Appeals affirmed the District Court in approving a Plan of Reorganization with an upset price sale of $525,000.00 which was found to be the fair value of the Debtor's property. The Court found that the Trustee's Plan of Reorganization with an upset price sale was properly within the language of Section 216(10) of Chapter X, that this suit is not a liquidation of Debtor's property and distinguished between the case before it and *Fidelity Association* v. *Sims,* 318 U. S. 608, 67 Sup. Ct. 807 when it held:

"Appellants also contend that the trustee's plan could not be confirmed in reorganization proceedings, because it was in reality not a plan of reorganization, but only a means of effecting the complete liquidation of the debtor's property, within the condemnation of *Fidelity Assurance Ass'n* v. *Sims,* 318 U. S. 608, 63 S. Ct. 807, 87 L. Ed. 1032. That case, however, held merely that a petition is not filed in good faith where liquidation, and not a readjustment of the rights of creditors, was at the very outset the only outcome to be expected. There the petition was attacked for lack of good faith in the initial stages of the proceeding, and the Court held that a proceeding could not be instituted under Chapter X where there was no chance of reorganization. Here when the petition was filed it did not appear that the debtor had no chance for reorganization or that reorganization would not be a reasonable method of serving the best interests of creditors and stockholders. The District Court found that the petition was filed in good faith, and that order was never appealed from. It cannot now be attacked for lack of jurisdiction. Bankruptcy Act, §149. The course of proceedings indicates also the good faith of the attempts to reorganize. One plan, indeed, was well on its way to being made effective as early as 1942. Only because of the completion of the buildings and the refinancing of the corporate indebtedness during the course of administration did liquidation become the more desirable method of winding up the debtor's estate.

"Under these circumstances *Fidelity Assurance Ass'n* v. *Sims, supra,* does not apply, and the trustee's plan was properly approved and confirmed by the District Court as being within the language of Bankruptcy Act §216(10), which provides that a plan of reorganization may include the sale of all or any part of the debtor's property at a fair upset price and the distribution of all or any assets among those having an interest therein. This conclusion is amply supported by our own decisions and those of other courts."

In support of its finding and conclusion the Court cited *V. Loewers Gambrinus Brewery Co.*, 141 Fed. 2d, 747, (2d Cir.); *Lorraine Castle Apartments Building Corp.*, (D. C. N. D. Ill.) 53 Fed. Cir. 994; *Central Sounding Corp.*, 75 Fed. 2d, 256, (2d, Cir.); *Porto Rican American Tobacco Co.*, 112 Fed. 2d, 665 (C. C. A. 2d).

It was only after these proceedings had been pending for almost eighteen months and the Debtor's best offer was payment of approximately 20% of the principal with a five-year extension of the balance on a total payment of 80% to the respective bondholders, that the Trustee who was appointed proposed a Plan which would result in payment to the bondholders of 100% of their claims. Thus it is apparent, and the Circuit Court of Appeals so found, that the approval of the Trustee's Plan and the disapproval of the Plans filed by the Debtor was in the best interests and requirements of fairness and equity and that the District Judge was acting within his authority and power as set forth by the statutes and the interpreting decisions in approving the Trustee's Plan of Reorganization.

B.

The District Court Properly Refused To Limit The Claims Of Holders Of Bonds Purchased During The Pendency Of The Proceedings Or Limit Their Voting Rights.

Petitioners have raised several objections with reference to the so-called speculators but have not clarified their position regarding the issues raised. The question has two distinct issues: should the holders who acquired bonds during the pendency of these proceedings be disqualified from voting upon the Plan of Reorganization; and/or be limited in the amount of their respective claims and be prevented from participating on a parity with the other bondholders.

1. The findings of fact entered by the District Court were reviewed and sustained by the Circuit Court of Appeals:

After a full and complete hearing on all of the matters presented before him, the Special Master found that there was no fraud involved in the purchase of these bonds and that the purchasers are not and never were in a fiduciary relationship with the bondholders, the Debtor, or stockholders of the Debtor.

It should also be noted that the Securities and Exchange Commission actively participated in these proceedings since July 22, 1943. The Commission, which is ever alert in matters of questionable ownership or purchase of securities, has taken the position and stated to the Court that there is no legal basis or justification for disqualifying the purchasers or disallowing or limiting their claims (R. 407). The Commission's position remained the same during the entire proceedings, including oral argument before the Circuit Court of Appeals.

On November 1, 1943, Petitioners presented a petition to the District Court to limit claims (R. 452-456). The Court considered this petition and the entire record before it and on February 18, 1944, entered an order granting leave to file a petition instanter and denied the prayer thereof (R. 451). On February 10, 1944, the District Judge, William J. Campbell, entered a memorandum of opinion in which he found (R. 446-451):

> "With reference to the acquisition of $52,000.00 bonds by speculators during the pendency of the proceedings, the Special Master has found that there was no fraud involved in the purchase of these bonds and that the purchasers are not and never were in a fiduciary relationship with the bondholders, the Debtor, or stockholders of the Debtor. The evidence in this case does not warrant disturbing the finding of the Special

Master on these two points, and, *as there is no proof that the bonds in question have been acquired by their present owners for the purpose of accepting or rejecting a Plan other than in good faith, this Court is not disposed to disqualify these bonds from voting* upon the Plan of Reorganization approved herein. *Sections 203 of Chapter X of the Bankruptcy Act;* In re *Pine Hill Colleiries Co.*, 46 Fed. Supp. 669, 671 (D. C. E. D. Pa., 1942; *Texas Hotel Securities Corp.* v. *Waco Development Co.*, 87 F. (2d) 395, 398 (C. C. A. 5th, 1937).

> "*Under the facts of this case, there is no occasion to limit participation in a plan by the holders of bonds purchased during the pendency of these proceedings to the amount of their cost.* In re *Utilities Power & Light Corporation*, 29 Fed. Supp. 763, 770 (D. C. N. D. Ill., 1939); In re *Celotex Co.*, 12 Fed. Supp. 1, 5 (D. C. Del., 1935); In re *Indiana Central Telephone Co.*, 24 Fed. Supp. 342, 344 (D. C. Del., 1938); *In the matter of Point Land Company*, 37 A. B. R. (N. S. 464, 466 (D. C. W. P. Pa., 1937))." (Italics ours.)

and entered an order approving the Trustee's Plan of Reorganization (R. 457-460).

The weight and consideration to be given to findings of fact, which in this particular case was the specific finding of fact that each of the above named individuals is not and never was in a fiduciary relationship with the bondholders is clearly set forth in Rule 52(a) of the Civil Rules of Procedure:

> "findings of fact shall not be set aside unless clearly erroneous and due regard should be given to the opportunity of the trial court to judge the credibility of the witnesses. The findings of a Master to the extent that the Court adopts them shall be considered as the findings of the Court."

There are numerous cases which support this ruling.

Cleo Syrup Corporation v. *Coca Cola Co.*, 139 Fed. 2nd, 416, 417, (C. C. A. 8th, 1943); *Webb* v. *Frisch*, 111 Fed. 2d 887 (C. C. A. 7th, 1940); *District of Columbia* v. *Pace*, 320 U. S. 698, 701, 88 L. Ed. 408, 410.

Prior to the adoption of the Rules of Civil Procedure the same rule prevailed.

In *Adamson* v. *Gilliland*, 242 U. S. 350 (1917), Mr. Justice Holmes said on page 353:

> "* * * the case is preeminently one for the application of the practical rule that so far as the finding of the Master or Judge who saw the witnesses, depends upon the conflicting testimony or upon credibility of witnesses or so far as there is any testimony consistent with finding, it must be treated as unassailable."

Petitioners do not and cannot contend that the record contains no evidence to support the findings of the Special Master and the District Court, which has been affirmed by the Circuit Court of Appeals. These findings should be given their full legal consideration.

2. As to the disqualification from voting.

Section 203 provides that if the acceptance or failure to accept a Plan by holders of any claim is not in good faith irrespective of the time of acquisition thereof, the Judge, after hearing, may direct that the vote of this claim be disqualified. The purpose of this section is to prevent creditors from participating, who by use of obstructive tactics and holdup technique exact for themselves undue advantages from the other stockholders who are cooperating. Bad faith is to be attributed to claimants who opposed a plan for a time until they were "bought off"; those who refused to vote in favor of a plan (notes 9 and 10 on Page

598, *Young* v. *Higbee,* 63 Sup. Ct. 594). However, even when a claim is disqualified the holder is entitled to participate on a parity with the holders of claims of a similar class in absence of fraud, breach of fiduciary or access to inside information.

After an examination of the present record, it is apparent that the sole purpose of the various purchasers was to make a profitable speculation, and that they did nothing to prevent, frustrate, interfere with or obstruct a plan of reorganization providing for the continued operation of the Debtor. As the Court stated there was no proof that the bonds in question have been acquired by their present owners for the purpose of accepting or rejecting a plan other than in good faith and for this reason there is no showing that the bonds in question should be disqualified from voting on the plan (R. 450-1). *Young* v. *Higbee Co.,* 65 Sup. Ct. 594, p. 598-599 (Feb. 1945), supports the position taken by the District Judge.

3. As to limiting claims in participation and amount.

As to the limitation of the amount of claims, the evidence amply demonstrates that the various individuals who purchased bonds during the pendency of the proceedings were complete strangers to the Debtor (R. 498). None of the purchasers were fiduciaries, or dealt with a fiduciary, or had access to inside information.

As a general rule, the holder of an obligation is entitled to recover from the maker the entire extent of the maker's promise to pay. The mere fact that the holders of bonds may have purchased them at less than par does not affect their rights (R. 488-489). In re *Utilities Light & Power Corp.,* 29 Fed. Supp. 763, 770. Again, "in absence of fraud the prices which security holders pay for their securities do not affect the measure of their participation under the Plan of Reorganization," *Standard Gas & Elec.* v. *Deep*

Rock Oil Co., 117 Fed. 2d, 615, 619. Sec. 212 of Chapter X which provides that the Judge may limit its costs, claims, or stock acquired in contemplation of or in the course of Chapter X proceedings by attorneys or Trustees, does not apply to strangers to the proceedings (R. 498).

The Special Master found that there was no fraud involved in the purchase of $52,000.00 worth of bonds by outsiders during the pendency of the proceedings and that the purchasers were not in fiduciary relationship with the bondholders, Debtor or stockholders of the Debtor. This finding was adopted by the District Judge (R. 446-451) and by the Circuit Court of Appeals:

> "These provisions are not applicable to third parties, to strangers, or to anyone who is under no fiduciary obligation toward any beneficiary of the trust." (R. 498),

and again:

> "Indeed the evidence offered by the debtor and its stockholders failed utterly to establish any possible fraud upon the corporation or any of the beneficiaries of the estate" (R. 498).

Consideration should also be given to the financial chaos which would result if purchasers of securities during the pendency of protracted proceedings of a corporate reorganization would be limited to the actual cost or purchase price of the various securities. This would not only encourage the Debtor in each instance to delay and prolong proposals for rehabilitation or reorganization of the Debtor in order to procure the Debtor's obligations at lesser amounts, but would also prejudice and hamper the negotiability and transferability of all securities. The only logical conclusion of the Debtor's request and the Debtor's conduct throughout these proceedings is that it was desirous of squeezing the bondholders and availing itself of Court reorganization procedure in order to prevent the respective bondholders

from realizing full value on their bonds, all to the particular pecuniary benefit of the Debtor itself. Petitioner undoubtedly is familiar with the decisions and legal principles set forth in *Case* v. *Los Angeles Lumber,* 308 U. S. 106, 60 Sup. Ct. 1.; *Consolidated Rock Products Co.,* 311 U. S. 636; *Northern Pacific Railroad Co.,* v. *Boyd,* 228 U. S. 482, in which the Court held that the owner of the equity is precluded from receiving an interest in the Debtor or its estate until such time as the prior liens are paid in full according to the terms and priority of the respective obligations.

A most pertinent case on this subject is *Mokova Corp.* v. *Dolan,* 147 Fed. 2nd, 340 (C. C. A. 2d, Jan. 1945), in which the Court stated on page 344-45:

> "Nor is it relevant that Meyer paid 50 or less for the second mortgage bonds he held. To reduce a creditors participation in the plan to the amount he paid for his bonds (except in unusual circumstances not present here) would be harmfully to reduce the value of such bonds to those who previously owned them."

There was no finding of fraud, breach of fiduciary relationship or access to information not publicly disclosed, on the part of the holders of the respective bonds so as to prevent their participation on a parity with the other bondholders. For the reasons herein contained these bondholders should not be disqualified from either voting or participating in the Plan on a parity with the other bondholders.

CONCLUSION.

As is ably said in the Opinion of the Circuit Court of Appeals, affirming the District Court:

> "Considering this picture as a whole and the findings of fact made by the Court in pursuance of the Special Master's recommendations, we cannot say that the ap-

proval of the trustee's plan was not in compliance with the Act of Congress or in the interest of fairness and equity (R. 502)."

It is apparent from the Opinion that the Court was familiar with the record and the issues. We submit that this statement is a considered opinion. The evidence and issues in this case have been thoroughly weighed by the Special Master, the District Court and the Circuit Court of Appeals. We sincerely believe that the petition for Writ of Certiorari fails to present any reason for a review of this case by this Court.

Respectfully submitted,

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